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Would the Adoption of the Trade Acceptance Be to Your Advantage?

Address Prepared by

SYLVAN L. STIX
Chairman
Trade Acceptance Committee
National Wholesale Grocers' Association
of the United States

For

Convention of the National Coffee Roasters' Association

Cleveland, December, 1918

Sent out with the Compliments of George H. Paine, Philadelphia, Pa.

WOULD THE ADOPTION OF THE TRADE ACCEPTANCE BE TO YOUR ADVANTAGE?

Mr. Chairman and Members of the National Coffee Roasters' Association:

Although I am a member of the Committee on Trade Acceptances of the Chamber of Commerce of the United States, which Committee was appointed to study the usefulness of trade acceptances, I want it thoroughly understood that I do not speak for either the Committee or the Chamber. Notwithstanding the impression on the contrary, the Chamber of Commerce of the United States has taken no stand on the question of trade acceptances and cannot be committed without submitting a referendum to its membership.

The National Wholesale Grocers' Association, on the contrary, has not only given the subject of trade acceptances considerable study, but has definitely gone on record as opposed to their general usefulness in the grocery trade and what we wholesale grocers found to be objectionable in this proposed change in our credit system would apply with more or less equal force to the vast majority of trades and average business transactions.

What we formerly lacked in American finance was the rediscounting privilege now established under the Federal Reserve Banking system. It has been the rediscounting of eligible single name commercial paper, bank acceptances and notes, and drafts or bills secured by staple products and merchandise or Government securities that have been the big factor in helping us meet the financial strain due to the war and not the rediscounting of the insignificant amount of trade acceptances which have figured to date.

You will note, I mention "bank acceptances" as having been of great value. There is no question as to the desirability and merit of the bank acceptance. That does not interfere with or threaten our American cash discount system. The bank acceptance does not disturb the present relation between buyer and

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seller. It simply represents a secured credit transaction between a bank and its client, but the trade acceptance, ah, that's another story.

A trade acceptance, as you undoubtedly know, is the buyer's written acknowledgment of a current merchandise debt, payment of which is not yet due. It is the buyer's negotiable guarantee that at a given time and place, he will pay the specified value of goods which have been delivered by the seller. Or to state it perhaps in more simple terms, it is a draft which the seller draws on the buyer, which, when accepted, obligates the buyer to pay for the value of goods delivered on a specified date and at a specified place. On the face, there is always a clause to the effect that the draft covers a purchase of goods from the drawer of the draft. The seller can keep these trade acceptances or discount them at his bank in the same way that he might handle a note receivable.

There have been many arguments used favoring the adoption of trade acceptances. In general, these arguments have been:

1. That their adoption would do away with the abuses of the open account system, namely, the taking of longer time than the terms of sale call for, discounting after the discount period has expired, canceling orders and making rejections as well as unjustifiable deductions and claims.
2. That by the adoption of the trade acceptance, we would shorten credit terms and decrease credit risks.
3. That their adoption would create a sounder financial policy, because a prime trade acceptance is supposed to be based on wealth in the process of distribution and thus be self-liquidating. That because a trade acceptance was to represent a superior credit instrument, it would command a lower discount rate and enable borrowers not only to increase their credit facilities, but at the same time to obtain these increased funds at a lower rate of interest.

4. That in advocating the trade acceptance here, we were simply attempting to inaugurate a system which had proved its usefulness in foreign practice.
5. That the trade acceptance and cash discount system can be used as alternative methods of making payment.
6. That the trade acceptance should be adopted for patriotic reasons as a matter of National importance, not only to meet the present war emergency, but to help America in securing and maintaining a primary position in world finance.

Now this question demands your attention: first as a seller, second as a buyer and third as a citizen.

As a seller, you will naturally be interested in cutting down the abuses of the open account system. We all know that the abuses referred to do exist, that there always has been a certain percentage of buyers who take advantage of sellers, but a change of system will not change human nature. What makes the seller stand these abuses? The fear of losing a customer. The seller's desire to conciliate a customer will always encourage such practices. At first the customer who does not discount and who might give a trade acceptance instead will probably pay his acceptances as they fall due, but as the novelty wears off, he will gradually fall into his old habits and ask for extensions as merchants used to do in connection with the old bills of exchange which were in use before our Civil War.

As practically all those who are advocating the adoption of trade acceptances now claim that they need not necessarily interfere with the cash discounter, (although originally the idea was to discontinue the cash discount privilege), it is hard to see how the adoption of trade acceptances as an alternative method of payment for those who did not discount would result in sellers being stricter with their discounting customers; so trade acceptances won't cure this abuse of discounting after the discount period has expired.

As orders are canceled before shipment and as trade acceptances are drawn after shipment, trade acceptances cannot certainly obviate cancellations.

As buyers frequently demand the right to return merchandise and get full credit for same months after having bought and paid for it under our present system, it is hard to see how a promise-to-pay instead of an actual payment is going to change this practice of returning purchases.

Now, coming to the arguments referred to in classification 2. The wholesale grocer's average bill in normal times runs about $25.00. Now, on account of the rise in values, they average about $40.00. Your bills being for a more restricted line to the same class of merchants will probably average less. Many of the most enthusiastic advocates admit that it would hardly be worth while to draw trade acceptances for bills amounting to less than $100.00. To draw acceptances against occasional bills of large amount and charge smaller bills to the same customer on open account would naturally be confusing and unsatisfactory. Advocates, therefore, suggest that in trades like the grocery trade and your coffee trade we draw trade acceptances for our monthly statements.

I am given to understand that the terms on which you sell your goods in some sections are two per cent. ten days or sixty days net, but that there has been a gradual change to a two per cent. ten-day or thirty-day net basis. This has been a move in the right direction. To use trade acceptances to cover your monthly statements to customers that did not discount would in practice establish or give official recognition to longer terms for your non-discounting customers than the terms that now to a very great extent prevail and would arrest any further tendency to the desirable short-term basis.

Naturally any increase in terms will of necessity increase the credit risk, because after all an account, whether in open form or closed by a trade acceptance, is not really paid because a buyer has signed an agreement to pay. You as a seller are still carrying the account.

Note the following advice, which we are given by one of the advocates of the trade acceptance:

"Your banker can and will give you valuable assistance in extending credit if you seek his advice. Take your trade acceptances to him, let him look them over and give you his opinion regarding the financial responsibility of the acceptors. Fortify your opinions with his judgment. His counsel will be a substantial help and every progressive banker will be glad to extend this help, because the trade acceptance strengthens the entire credit system of the country."

Now just imagine to what extent this advice applies to the kind of acceptances that you would be apt to get. The trade acceptance to the extent that you adopt it would be nothing more or less than a collection device, and even as such will, as I said before, lose this value as the novelty wears off. Taking for granted that you could obtain trade acceptances from your customers without offering them unwarranted inducements, a matter I will refer to later, the detail incidental to handling trade acceptances for such small amounts would not be looked upon with any more favor by the banks than by you as borrowers. Most banks would prefer loaning a merchant in good credit a round sum of money on his own note than discount instead a mass of small trade acceptances, many of which would probably not be met when due.

Now we come to the points referred to under heading three.

If as a seller you take a trade acceptance for an outstanding you must endorse it before you can discount it at your bank. This makes you just as liable as you would be for a loan on the basis of this receivable in book account form. The only difference is one of method.

Although advocates claim trade acceptances make immediately available all outstandings (this is the so-called liquidity of trade acceptances), most bankers in actual practice would lend more readily on single name paper than on the general type of trade acceptances that is now being encouraged. With them it is not a question of the form, but a question of the amount and character of the assets back of the loan.

Trade acceptances are subject to the same possibilities of abuse as single name paper. It is claimed against single name

paper that it might represent investments in fixed assets, such as fixtures, machinery, plant, etc. As against this, it is to be noted that the National Association of Credit Men, one of the Associations which has been most active in this trade acceptance propaganda, passed a resolution at its last convention to the following effect:

"RESOLVED that the National Association of Credit Men, in convention, directs an earnest appeal to Secretary McAdoo, as Director-General of Railways, that approval and authority be given the railroads now under Government operation and control, to settle for their purchases with Trade Acceptances as a means first of largely utilizing the credit of railroads in a manner that seems most naturally to fit into our great banking system, and second, as affording the best possible method of giving the stamp of Government approval to the use of the acceptance in settlement of merchandise obligations, a matter of great importance, because there is thus created that great body of acceptance paper which will give the fullest guarantee of a highly liquid banking condition."

Now let us analyze what such trade acceptances would represent. Would they not to a very great extent represent cars, locomotives, rails, ties, etc.? Nice liquid assets, to be sure. Furthermore, such purchases would represent coal, oil, etc. Trade acceptances covering purchases of this latter class would not represent wealth in the process of distribution, but to a very great extent, wealth in the process of consumption or that has been consumed.

The "Trade Acceptance Journal," surely an authority on trade acceptances, states in its October number:

"The prime Trade Acceptance is one based upon the current purchase of merchandise intended for resale, and which thus has the self-liquidating feature so much to be desired.

"The acceptance arising between the retailer and his customer who buys for private consumption loses its self-liquidating feature in that the goods purchased are consumed directly by the purchaser and the Trade Acceptance then

becomes simply an order upon his future earnings, which, of course, are first subject to his future requirements.

"The 'Journal' does not believe that the Trade Acceptance arising between the retailer and his customer should find lodgment in the Federal Reserve System, because it does not believe that such acceptances are a good basis for the issuance of currency."

At first, members of the American Trade Acceptance Council went so far as to advocate that retailers, even retail grocers, should ask for trade acceptances from their customers, but they have of late changed their position to conform to the above-quoted point of view.

Now the railroad to the extent that it purchases coal, oil, etc., is in just exactly the same position as a consumer who buys for private consumption from a retailer. Fortunately, the resolution of the National Credit Men's Association has not been favorably considered by Secretary McAdoo, but if the strongest advocates of the trade acceptance fall into such errors, is it not fairly safe to assume that trade acceptances will not represent on the whole any more liquid or securer class of paper than we now have in our single name paper. The insignificant losses that have been sustained by our banks on such single name paper are ample evidence of the soundness of the prevailing system.

Under our American system, the vast majority of transactions are subject to a discount for cash; a discount which no first class credit risk can afford to lose. Those who take this discount have no occasion to use trade acceptances, therefore, trade acceptances to the extent that they are being used at all, represent to a very great extent a poorer class of credit risk.

In this connection, the following warning appeared in the "Federal Reserve Bulletin" of September 1st, 1917:

"Acceptances in order to fulfill their most important mission must be representative of the best of mercantile credit; otherwise, they will necessarily come to occupy a secondary position, as the embodiment of the less fluid elements of the country's business."

More recently a much stronger statement to the same effect was issued. It is significant in this connection to note that formerly the Federal Reserve Board established a differential of half of one per cent. between the rediscounting rate of single name paper and of trade acceptances. This differential has lately been reduced to a quarter of one per cent., and should, for reasons outlined, be wiped out entirely.

Now as regards the foreign practice. Usually, when a merchant in England makes a purchase, the seller mails with his invoice an acceptance form. This the buyer signs as an acknowledgment of his obligation, and this instrument becomes an order on the buyer's banker to pay the amount at a certain date. The buyer, instead of returning the draft to the seller, forwards it to his acceptance house or some banking institution of which he is a client. This acceptance house, as per its arrangement with the buyer, places its own acceptance upon the draft or acceptance and then forwards the document to the seller of the goods; thus the acceptance house or banker assumes responsibility as against the event of the buyer failing to make payment when due. The acceptance house charges its client a commission for assuming this responsibility.

Such an acceptance practically relieves the seller of all contingent liability. It is the strength of the acceptance house or banker which gives this foreign acceptance its standing, and such acceptances find a ready market, irrespective of the credit standing of either the buyer or the seller. Such an acceptance, you will note, is essentially different from the trade acceptances advocated here.

There are really very few reasons that even those who advocate the adoption of trade acceptances can give that appeal to the ordinary merchant as a buyer. Let us quote from a recent speech of one strong advocate, Mr. William G. Avery, of the Guarantee Trust Company of New York:

"As to the buyer, our arguments must necessarily be more in the abstract, although they are none the less forcible in the face of the experience of a great number of firms who are now giving their acceptances freely. The buyer in most

cases eventually becomes the seller of the goods he buys; therefore, the advantages enumerated as belonging to the seller also accrue to him, especially if he is a wholesaler."

Then Mr. Avery goes on to say that the giving of acceptances encourages careful buying, improves a firm's financial standing and relieves the buyer of the necessity of borrowing from his bank to pay for goods which he can pay for with acceptances.

I do not see how these arguments could apply to your business. For reasons previously stated, you could not use trade acceptances to advantage as a seller and, therefore, you would feel no necessity to encourage their use as a buyer. In fact, you now enjoy certain decided advantages as a buyer under the prevailing system in being able to make a banking profit by discounting your bills. Sellers not only allow you a discount for cash equivalent to what the money is worth to them, but a further discount as an insurance against the credit risk. I do not believe that you as coffee merchants are any more inclined to lose the banking profit you now make in the shape of a cash discount than we care to as wholesale grocers.

Furthermore, most of the people you buy from now refuse to extend over thirty days' credit and this would not be sufficient in most cases to enable you to finance yourselves. Therefore, you would have to resort to the discounting of your single name paper anyway, and a firm that discounts trade acceptances which it receives from its customers or gives trade acceptances in payment of merchandise, will find that they have limited their credit facilities to their own banks.

From a pamphlet on trade acceptances just issued by the Massachusetts Bankers' Association, I quote as follows:

> "While a concern which confines its borrowings to its depository banks may, if agreeable to them, discount trade acceptances simultaneously with borrowings on single name notes, yet banks must impress upon their customers that those who use the outside market for loans must confine their financing to one system or the other."

Although originally, when trade acceptances were advocated, there seemed to be a general disposition to claim that the cash discount system was passé, so many sound arguments were made in favor of retaining cash discounts that the tendency of late is to claim that both systems can be used as alternative methods of payment, but there is a question, whether this attitude has not been adopted more as a temporary measure to help the introduction of the trade acceptance. It seems almost inconceivable that thoughtful men would not realize that the two systems must necessarily be inherently antagonistic, because when used as alternative methods of payment, the trade acceptances obtained would represent to a very great extent secondary credits; namely, accounts not strong enough to take advantage of the discount profit.

Although Mr. Pierson, Chairman of the American Trade Acceptance Council, has claimed again and again that those who are interested in the study of trade acceptance development wish to make it perfectly clear that they contemplate no attack upon the cash discount, he has but recently put the stamp of his approval on a report made by Mr. R. R. Ellis, Chairman of the Trade Acceptance Adoption and Cash Discount Elimination Committee of the National Wholesale Druggists' Association, in which Mr. Ellis says:

> "This is a serious mistake of the trade acceptance advocates—the overlooking of the net price sales plan—for it is necessary to the perfecting of the trade acceptance vehicle."

Now Mr. Pierson says of Mr. Ellis' report that it "comes nearer to being absolutely opportune than anything recently issued." There certainly seems to be some inconsistency here.

In the "Acceptance Primer," published by the Foreign Trade Banking Corporation, self-styled as "America's Pioneer Discount Bank," we find the following statement:

> "Compared with the open book account, cash discount and single name paper methods of conducting business transactions, the use of the trade acceptance is more sound and economical."

No side-stepping here.

In the "Trade Acceptance Catechism," published by the American Trade Acceptance Council, on page 6 we find the following statement:

> "Yes: the 'open book account—cash discount—single name paper' system has long been recognized as wasteful, archaic, non-liquid, and attended by many abuses and disadvantages. The leading purpose of the acceptance is to put our mercantile and banking credit operations upon a sounder and more liquid basis by substituting for the open book account prime, double name commercial paper readily available for the discount market."

On page 9 of the same pamphlet, we find the following:

> "Will the trade acceptance interfere with established cash discounts? Not at all, except where special acceptance discounts may be offered."

Here again, we find the same inconsistency.

In the September number of the "Trade Acceptance Journal" we find an article by Mr. Hilles, which seems to let the cat out of the bag. He says:

> "Historically the cash discount and the trade acceptance may not be permitted to associate with each other, but history is not business. Let us keep our precious cash discount (for a little while if necessary) for the man who has money in the bank and at the same time help stabilize and systematize the business of the man who has not the bank account or the borrowing capacity."

So perhaps this is the idea. We must be weaned gradually.

Later on, in the same article, Mr. Hilles makes this further statement:

> "National credit standards will be 'international' after the war. Sixty and ninety days' time will not mean slow pay."

We will certainly, under such conditions, need the Almighty to protect us from the real slow payer.

In the October number of the same journal, in an article by Mr. Blanchard, another convert to the trade acceptance, he says:

> "If you find your funds tied up in book accounts and have not sufficient available cash, with the aid of trade acceptances, you can buy the supplies you require, *discount your bills and make a larger profit* on your investment through increased yearly sales." *

Later on in the same article:

> "If you run a little short of ready cash and have a bill for material that you are anxious to *discount, which we all know increases your profits and builds up your credit,* you do not have to call up this or that customer to ask him if it is convenient to let you have something on account, so that you can pay your bills. Go to your security drawer, pick out enough acceptances to total the bill and discount them at your bank." *

What is good for the goose is good for the gander. If Mr. Blanchard considers that it increases his profits and builds up his credit to discount his bills, would not the same be true of his customers? Mr. Blanchard is in the cement business. He suggests the following alternative terms:

> "Two per cent. discount for cash on the 10th of the month following delivery, or trade acceptance for the full amount due on the 25th of the same month."

Namely, he suggests discounting with his bank and having his bank rediscount with the Federal Reserve Bank trade acceptances from firms whose credit is so light that they have to sacrifice two per cent. for fifteen days' accommodation, or at the rate of forty-eight per cent. per annum.

In this same October number, we find an article from another advocate, a Mr. Bethel, a clothing manufacturer. He says:

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*Italics are mine.

"We hear a great deal about the trade acceptance not being adaptable to certain classes of business, on account of the disturbance to the long-established cash discount. I do not propose to discuss this point, as it has been fully covered many times in this and other publications. I will say in passing, however, that my own house adopted the trade acceptance while it was offering cash discount and dating, and did it successfully. In fact, we introduced the use of the acceptance while on the discount basis. Furthermore, we did not eliminate the discount and dating on account of the trade acceptance, but because of conditions in our industry which required larger investments and largely *spot* payments on our part, as well as because the tendency in our section of the clothing trade was to eliminate discount and datings." *

Now here are two significant facts. One is that the cash discount was eliminated by Mr. Bethel's firm, whether wisely or not, since they have adopted the trade acceptance; two, he claims that as an excuse for doing so, they themselves were being compelled to largely make spot payments. They apparently were not as successful in inducing their creditors to take their own acceptances, as they were in gradually educating their own trade to the use of acceptances and finally denying them the cash discount privilege.

The inducements that certain firms are offering their customers to obtain trade acceptances, either by extending longer terms of credit on an acceptance basis, or by offering an unearned cash discount for giving an acceptance, are unwarranted, and, being so, will sooner or later be withdrawn.

Can anything be more unsound, for instance, than the plan that has often been suggested as desirable for introducing trade acceptances; namely, of allowing the customer the cash discount on, say, a two per cent. ten- or sixty-day net bill, taking his sixty-day acceptance for the amount of such a bill, less the two per cent. cash discount, and adding on the interest at the rate of six per cent. per annum?

*Italics are mine.

Any merchant who adopts such a plan would be allowing a cash discount without getting what he had paid for; namely, the cash and the elimination of the credit risk. He would be in reality grossly extending his average credit period. He would become contingently liable on all such trade acceptances which he discounted and to the extent that he discounted such paper, he would be making his bank a preferred creditor and to that extent, hurting his own credit. If the trade acceptance has real advantages, it should not need such methods to win favor.

Then what do the advocates of the trade acceptance really mean when they say they contemplate no attack on the cash discount? It is generally conceded that there should be no extension of the period of credit customarily given. Does that mean that those who advocate the trade acceptance and also claim they contemplate no attack on the cash discount system, consider a four months' loan on a promissory note, to enable a merchant to discount his bills, instead of paying such bills on a sixty- or ninety-day net basis, an extension of the period of credit?

Although indirectly there is an extension of credit when a man borrows on four months' time to discount bills that would be due on a net basis in sixty or ninety days, such loans in the first place need not of necessity be for four months, and, furthermore, such single name paper discounted by banks or bankers, who have an intimate knowledge of the borrower's financial condition and who look for two dollars' worth of assets for every dollar they loan, is sounder as a basis for Federal Reserve notes than trade acceptances drawn by the same borrowers for the much talked of 100 per cent. of the same assets.

In such a claim would like the real attack on the cash discount system, because then only firms that had sufficient capital to discount their bills without borrowing money to do so would be in a position to continue to avail themselves of the discount for cash and the number of such firms would be negligible.

The advocates of the trade acceptance have failed to meet this issue. Probably because they realize that any such contention would antagonize the American business man, whom they

are trying to win over and who can be relied upon to know pretty well on which side his bread is buttered.

In closing, let me assure you that if you do not consider it is going to be an advantage to you in your particular line of business to adopt trade acceptances, there is no reason why you should feel any public obligation in the matter. In this connection, I quote from a letter from Governor Harding, of the Federal Reserve Board, in which he states:

> "The Board has no desire to influence any one to use the trade acceptance against his will and deprecates the use of the word 'patriotism' in this connection."

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